

# Funding Your Retirement System

**Addressing TRS' Shortfall**

Montana Teachers' Retirement System

After the 2008-2009 market collapse, TRS had a **negative 20.8%** return on investment. We're still absorbing that loss.

Also, contribution rates have not kept pace with benefit costs.

As a result, TRS has a **\$1.8 billion** unfunded liability.

Current statutory contribution rates already fund two-thirds of that liability, leaving a shortfall of about **\$633 million**.

Based on the 2011 actuarial valuation, this represents a **3.53% gap** between current contribution rates and being actuarially funded over a 30-year amortization period. In short, TRS needs additional funding of approximately **\$30 million a year**.

How can we reduce or erase that 3.53% shortfall?

- ✓ Increase contribution rates
- ✓ Reduce benefit rates (contract rights issues)
- ✓ Secure new sources of revenue, or
- ✓ Find a workable combination of all three.

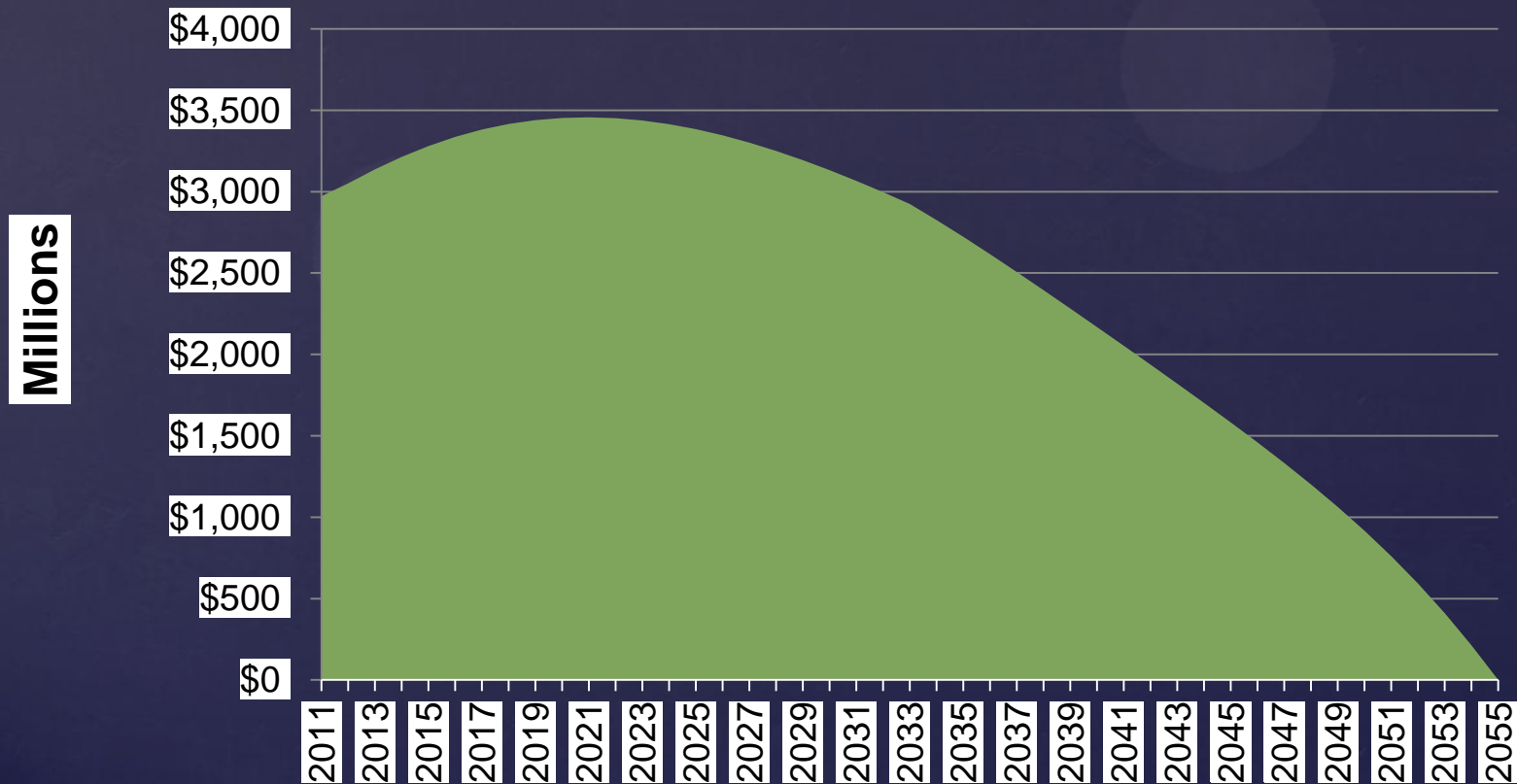
We don't have to erase the shortfall all at once—we have time, a window of opportunity, **if we act *now*.**

However....

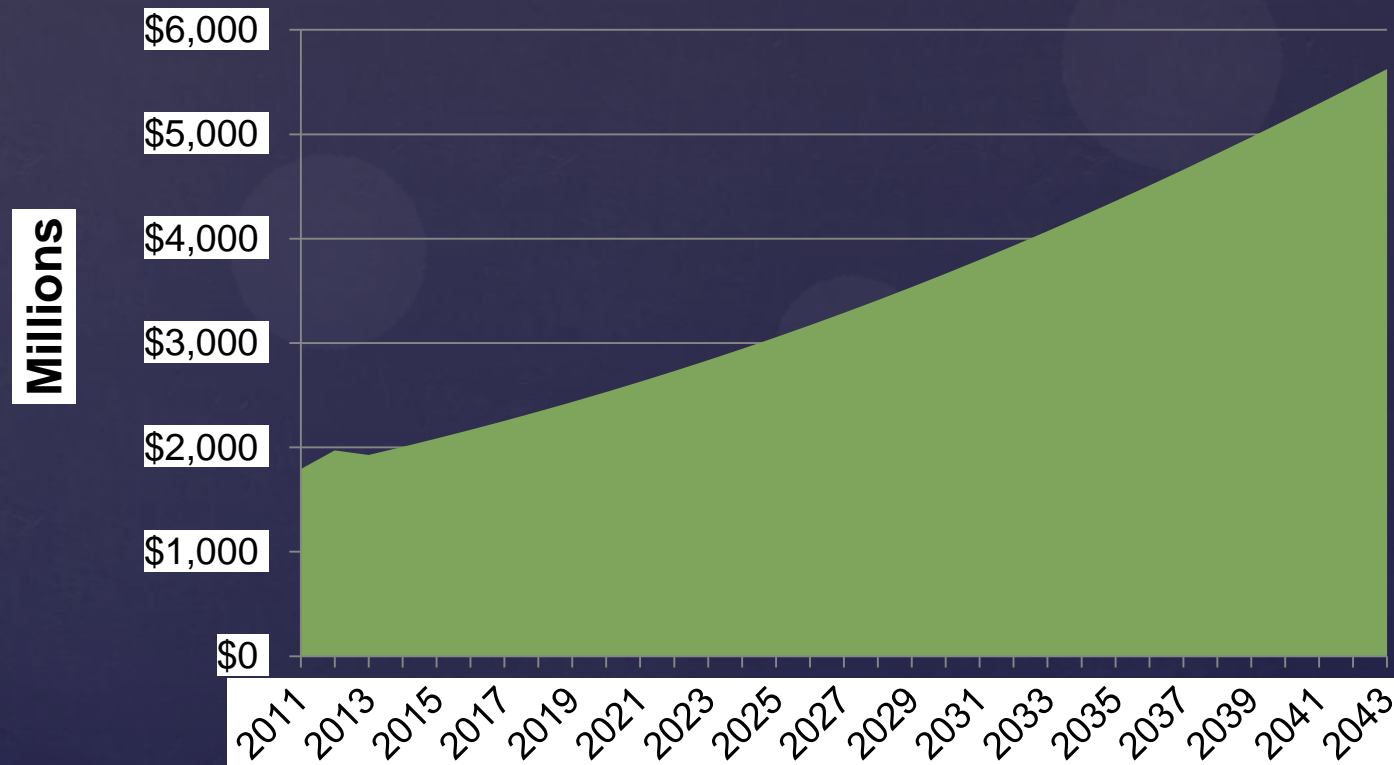
Unless the 2013 Legislature enacts corrective measures, the unfunded liability will grow, doubling in the next 20 years, and the TRS pension fund will run out of money by 2055 (or sooner).

# Projected TRS Assets

(with current contribution rates)



# Projected TRS Unfunded Liability





# What Can We Do?

Prudent, relatively small changes now can avert the need for more drastic measures later.

We're looking at what other states have done:

Raising revenues

- Increase contribution rates
- Tap new funding sources

Reducing benefits

- For current members
- For new hires

We need a combination — a package everyone can live with.



# Changes can be Adaptive and Phased in Equitably

Set triggers to adjust contribution and/or benefit rates up and down

- Responsive to investment returns
- Prevent slipping back into a hole

Apply some changes only to new hires and those in the early years of their careers

- Avoid harming retirees and those nearing retirement

# Can a Contract Be Changed?

Contracts are not absolute.

A three-part test is commonly applied in contract rights cases:

1. Is there a contract? Is there an impairment of the contract?
2. Is the impairment substantial?
3. Is the impairment reasonable and necessary and justified by an important public purpose?

# Estimated Effects of Possible Changes

(Effects are not additive)

Alternative	Existing Plan (3.53% shortfall)	Change to:	Reduces Shortfall By:
Raise Employee Contribution Rate	7.15%	7.65% (+0.5%)	0.37%
		Or 8.15% (+1.0%)	0.81%
Raise Employer Contribution Rate	7.47%	8.47% (+1.0%)	1.0%
Raise State General Fund Rate	2.49%	3.49% (+1.0%)	1.0%
Raise Average Final Compensation	3 years	5 years	0.91%
Reduce Multiplier	1.667%	1.50%	2.17%
Reduce Guaranteed Annual Benefit Adjustment	1.50%	1.25%	0.39%
Raise Vesting	5 years	10 years	0.10%
Raise Early Retirement	Age 50 & 5 yrs	Age 55 & 5 yrs	0.05%
Raise Regular Retirement	Age 60 w/5 yrs, or 25 yrs	Age 60 w/5 yrs, or 30 yrs	0.87%
		Or Age 65 w/5 yrs, or 30 yrs	1.94%

# Possible Changes to New Hires

Other states are adjusting contribution and benefit rates and modifying other plan elements for new hires. This is easier than making changes that would affect the contract rights of current members.

Changes to new hires can make the system more cost-efficient over time. But relatively few new hires enter the system each year, usually at the lower end of the pay scale. Small numbers mean a small initial impact on the system. **Changes to new hires alone are not enough to pay down the unfunded liability before TRS runs out of money.**

# Changes for New Hires

- Increase contribution rates
- Raise Average Final Compensation
- End 25-year retirement at any age
- Raise normal retirement age
- Raise early retirement age

## DC and Hybrid Options

Closing the Defined Benefit (DB) plan and moving to a Defined Contribution (DC) 401(k)-style plan would make the situation worse. It would:

- Do nothing to pay down the unfunded liability
- Increase total costs to the state (taxpayers)
- Reduce retirement security for members
- Impair recruitment and retention of the best career-minded people

A more viable option might be a hybrid DB/DC plan or a Cash Balance plan.



# Hybrid/Cash Balance Options

## Defined Benefit/Defined Contribution Hybrid

- Minimal DB plan (e.g., 1.0% multiplier and 5-year AFC, plus:
  - Employee contribution to DC, with a small employer match
  - Member responsible for DC investing

## Cash Balance Plan

- Accumulated account balances
- Guaranteed rate of return (e.g., 4% to 9%)
- No loss of principal, assets are professionally managed
- Annuity at retirement



# Summary

The TRS fund can be righted with prudent, incremental, and relatively small adjustments.

The \$633 million shortfall can be made up through a combination of contribution increases, benefit reductions, changes to plan elements, and new funding sources.

The sooner we make these adjustments, the better the outcome will be for everyone—teachers, retirees, employers, and taxpayers.

# We Want to Hear from YOU!

Consider the possible changes shown in the table on page 11. Add your own good ideas. Come up with a package of options you can live with.

Take our survey at [www.surveymonkey.com/s/R82MJSQ](http://www.surveymonkey.com/s/R82MJSQ) to tell us which changes you support and which you oppose.

Or call us or send an email or letter:

Email: [wharmon@mt.gov](mailto:wharmon@mt.gov)

Phone: 406-444-0139

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We'll use your input to develop a proposal for the 2013 Legislature.